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FROM THE OFFICE OF THE SUPERINTENDENT OF
FINANCIAL INSTITUTIONS CANADA (OSFI)

Pillar

Brand Canada features strong financial services sector

Excerpt from remarks by Superintendent Julie Dickson to
the Financial Services Institute — June 26, 2008

Canada's Brand

A strong banking system is a critical element of a strong national economy. And internationally, the reputation of a country's financial system is largely based on the soundness of its banks, because banks — and their interactions with one another — are at the core of the global financial system.

Recently a person based in the UK referred to "Brand Canada". The person noted that, internationally, the Canadian "brand", is very strong. This is based on the perceived strength of the underlying fiscal and economic fundamentals, and the lower risks associated with Canadian banks, the corporate sector and the household sector.

Further, I am told that the recent financial market dislocation has enhanced interest in Canada — especially from a counterparty credit risk perspective —

because market participants are aware that Canada is weathering the turbulence better than some others. Canadian banks are generally seen as strong counterparties as they tend to be more conservative and better capitalized than many other banks.



Superintendent
Julie Dickson

The Canadian regulatory brand is also extremely strong internationally. OSFI has played leading roles on the Basel Committee and the International Association of Insurance Supervisors (IAIS). OSFI has been assessed twice by the International Monetary Fund (IMF), and we received top marks on both occasions, most recently in February 2008. We recently volunteered to be assessed again on our implementation of Basel 2. The international...

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OSFI issues draft advisory on securitization exposures

On June 19, 2008, the Office of the Superintendent of Financial Institutions (OSFI) issued a draft advisory on the capital treatment of securitization exposures for Canadian Federally Regulated Entities (FREs).

Superintendent of Financial Institutions Julie Dickson stated that, "This updated draft advisory takes into account some observations made in Canada during the recent disruption in the asset-backed commercial paper (ABCP) market, and internationally as a result of the global financial market turmoil."

To view the associated draft advisory, visit the OSFI Web site at: www.osfi-bsif.gc.ca

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...assessors were on site in April and May, and we expect them to issue a report soon.

The institutions we regulate frequently tell us that their ability to enter into other markets is enhanced by the strong reputation OSFI has internationally. This did not happen overnight. It has taken consistent effort to remain in the top tier of prudential regulators internationally, and I am pleased that we have been able to maintain our position.

While turmoil in global financial markets remains an issue, the Canadian banks have withstood a tremendous amount of strain to date. The Canadian banks' ability to cope was evidence not only of their own efforts, but also of prudent oversight and supervision, including features of the Canadian market such as strong capital positions. Further, there was less dis-intermediation in Canada (Canadian banks securitized fewer assets than others) which means that fewer assets have to be put back on balance sheets than elsewhere. That being said, financial market turmoil is still with us and we are definitely not out of the woods. But increased disclosure by banks means that markets are better positioned to predict the further losses that may occur. Going forward, as noted in the Bank of Canada's FSR, a key downside risk would appear to be a deeper than currently expected downturn in the U.S., which could also trigger further significant write-downs and an erosion of profitability.

However, everywhere I go, many people say to me that Canada has fared well in comparison to many other countries. This theme was recently repeated by an official of the IMF and a former chair of the Federal Reserve.

In Canada, non-bank ABCP was in the spotlight as one of the more visible fallouts from the global liquidity crunch. Some commentators suggested that OSFI had lax rules, or unique rules that allowed the non-bank market to flourish. In fact, OSFI's rules were irrelevant for non-banks and OSFI had robust capital guidelines that helped the Canadian banking system better withstand the turmoil than other countries.

First, OSFI had a target capital requirement of 7 per cent for Tier 1 capital, and 10 per cent for total capital. Many others countries simply relied on 4 per cent for Tier 1 and 8 per cent for total capital.

Second, OSFI does not allow banks to take on risk without having the commensurate amount of capital to backstop that risk. Thus, we had a capital rule that said that if banks were taking on risk by acting as unconditional liquidity providers to ABCP conduits, they would have to put up the requisite capital to backstop the risk in those liquidity lines.

"Brand Canada" is strong capital, both in terms of level and quality. "Brand Canada" is also increasingly being linked to robust disclosure by banks. Canadian banks achieved substantial compliance with the enhanced FSF disclosure recommendations even though their mid-year reporting is a full two months ahead of North American and European banks.

In addition to robust capital and oversight and supervision, there are other elements that make up a strong Canadian financial system.

As an example, from a bank supervisory perspective, Canada is seen as a model in terms of inter-agency communication. I, along with the Governor of the Bank of Canada, the Chair of the Canada Deposit Insurance Corporation (CDIC), the head of the Financial Consumer Agency of Canada (FCAC), and the Department of Finance continually meet as a group, and we greatly increased that interaction beginning in early August 2007. We do not need instructions to facilitate this interaction; we do it because inter-agency communication is important, and it strengthens the Canadian financial system.

Canada also has a world-class deposit insurance system. The UK is currently looking to the CDIC for help and guidance on what makes a good deposit insurance system.

A strong banking system is not an accident, and OSFI plans to build on the current strengths in the system, to make it even more resilient to future challenges. OSFI has already begun work on implementing the 60+ changes which are recommended in the recent Financial Stability Forum report. These changes are prudent and necessary, and will serve to further strengthen Canada's financial brand.

To view the full text of the Superintendent's remarks, visit the OSFI Web site at: www.osfi-bsif.gc.ca

OSFI releases Draft Advisory on Innovative Tier 1 instruments

The above mentioned Draft Advisory is to update existing guidance related to innovative Tier 1 instruments pursuant to the following OSFI guidance:

- Guideline A and A-1, Capital Adequacy Requirements (CAR) Banks/T&L/BHC
- Guideline A, Minimum Continuing Capital and Surplus Requirements (MCCSR) Life
- Guideline A-2, Capital Regime for Regulated Insurance Holding Companies and Non-operating life Companies
- June 2007 Advisory: Innovative Tier 1 and Other Capital Clarifications – Revised Version

There are two areas where existing guidance is changed or reinforced:

First, a new form of loan based qualifying innovative instrument is being considered for inclusion in Tier 1 capital.

Second, enhanced disclosure requirements are introduced for qualifying asset-based and loan based innovative Tier 1 instruments issued after July 1, 2008.

Questions concerning the draft Advisory should be addressed to Paul Melaschenko, Capital, Accounting and Research Division, at (613) 990-6429, by facsimile at (613) 991-6822 or by e-mail at paul.melaschenko@osfi-bsif.gc.ca before July 15, 2008.

To view the complete document, visit the OSFI Web site at: www.osfi-bsif.gc.ca

OSFI releases Draft Advisory on the recognition of hedge contracts in the determination of the segregated fund guarantee capital requirement for life insurance companies

Guideline A, *Minimum Continuing Capital and Surplus Requirements (MCCSR) for Life Insurance Companies*, and the OSFI Instruction Guide *Use of Internal Models for Determining Required Capital for Segregated Fund Risks (MCCSR)* describe the capital requirements for life insurance companies with segregated fund guarantee risk exposure.

The Draft Advisory clarifies OSFI policy with respect to recognition of hedges in the determination of a life insurance company's segregated fund guarantee capital requirement.

To view the complete document, visit the OSFI Web site at: www.osfi-bsif.gc.ca

OSFI 2008 AML/ATF Conference Held in Toronto

The OSFI Anti-Money Laundering and Anti-Terrorist Financing Information Session 2008 took place at the Metro Toronto Convention Centre on May 7, 2008. The event was attended in person by over 300 representatives from financial institutions, Montreal and Vancouver based institutions taking part via closed circuit broadcast.

The information session covered such topics as the Risk Based Approach, Self Assessments, Independent Testing, and an overview of issues around Politically Exposed Persons. Superintendent of Financial Institutions Julie Dickson was also in attendance and addressed the audience on the importance of maintaining vigilance in this area. Presentations from the event are available on the OSFI website.

OCA releases Actuarial Report on the Pension Plan for Members of Parliament

This actuarial report prepared by the Office of the Chief Actuary (OCA) on the pension plan established under the *Members of Parliament Retiring Allowances Act* (MPRAA) was made as at 31 March 2007 pursuant to the *Public Pensions Reporting Act* (PPRA). The previous review was made as at 31 March 2004. The date of the next periodic review, as per the PPRA, is 31 March 2010.

In accordance with accepted actuarial practice, the main purpose of this actuarial report is to show realistic estimates of:

- the balance sheet of the Plan as at the valuation date, i.e. its actuarial liabilities, its notional assets, and the excess of notional assets over the actuarial liabilities as at that date;
- the annual amount to amortize over a given period of time any actuarial deficit revealed as at the valuation date; and
- the projected costs for the Plan of the three Plan years following the valuation date.

The previous valuation report took into account the results of the general election held 28 June 2004. It also took into account the amendments arising from Bill C-30 that was introduced in December 2004, after the previous valuation date. Bill C-30 received Royal Assent on 21 April 2005.

As at 31 March 2007, the Members of Parliament Retiring Allowances (MPRA) Account had an excess of assets over the actuarial liabilities of \$132.3 million and the Members of Parliament Retirement Compensation Arrangements (MPRCA) Account had an actuarial deficit of \$3.2 million.

To view the complete document, visit the OSFI Web site at: www.osfi-bsif.gc.ca

What's New Online (www.osfi-bsif.gc.ca)

Humanitarian relief exemption permit issued under the SEMA (BURMA) Regulations

The Minister of Foreign Affairs issued an exemption permit under the *Special Economic Measures (Burma) Permit Authorization Order* to a series of Canadian non-governmental organizations engaged in humanitarian relief in Burma in response to the Cyclone Nargis disaster.

Changes to Life Income Fund Pension Regulations

Regulatory Changes Related to Federally Regulated Life Income Funds and Locked-in Registered Retirement Savings Plans are effective as of May 8, 2008.

Superintendent remarks on Property and Casualty Industry

OSFI has posted a speech by Superintendent Julie Dickson to the Langdon Hall Property and Casualty Insurance Industry Forum.

OSFI's standard templates for Letters of Credit

OSFI's standard templates for Letters of Credit have now been posted to the web site.

To view the complete documents, visit the OSFI Web site at: www.osfi-bsif.gc.ca

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The OSFI Pillar

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